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BEFORE THE ARIZONA CORPORATION COMMISSION

2 KRISTIN K. MAYES
Chairman
3 GARY PIERCE
Commissioner
4 PAUL NEWMAN
Commissioner
5 SANDRA D. KENNEDY
Commissioner
6 BOB STUMP
Commissioner

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AZ CORP COMMISSION
DOCKET CONTROL

8 IN THE MATTER OF THE REVIEW AND
POSSIBLE REVISION OF ARIZONA
9 UNIVERSAL SERVICE FUND RULES,
ARTICLE 12 OF THE ARIZONA
10 ADMINISTRATIVE CODE.

DOCKET NO. RT-00000H-97-0137

11 IN THE MATTER OF THE
12 INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

13 QWEST CORPORATION AND QWEST COMMUNICATIONS COMPANY LLC

14 JOINT INITIAL BRIEF

15 (PUBLIC VERSION)

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17
18 Norman G. Curtright
19 Associate General Counsel
20 Qwest Corporation
Qwest Communications Company LLC
20 E. Thomas Rd.
Phoenix, Arizona 85012

21 Arizona Corporation Commission
DOCKETED

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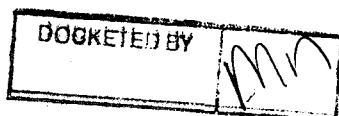


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1 Qwest Corporation ("QC") and Qwest Communications Company, LLC ("QCC")
2 (together referred to below as "Qwest"), jointly file their Initial Brief following the evidentiary
3 hearing held in these consolidated dockets on March 16-18, 2010.

4 I. Summary

5 Switched access is a service which allows long distance companies ("IXCs") to connect
6 to the local customers of a local exchange carrier (a "LEC"), which may be an incumbent
7 ("ILEC") or a competitive local exchange carrier ("CLEC"). The switched access charges are
8 paid by the IXCs to the LECs, and as a matter of regulatory policy from their inception, were
9 meant to subsidize local exchange service and keep rates to consumers low.¹ Switched access
10 charges exist in both the federal (interstate) jurisdiction, and the state (intrastate) jurisdiction. No
11 party seriously disputes that the ultimate objective of federal and state regulation should be to
12 minimize, if not eliminate, the implicit subsidies of the access charge regime. The Arizona
13 Corporation Commission ("Commission") has previously stated that a long term goal is to have
14 intrastate access rates mirror the interstate rates of the LECs. The hard question is how to get
15 there, and how long will it take. Should there be a system of explicit subsidies, such as funding
16 from a universal service fund, as part of the answer? These are the issues presented in these
17 consolidated Access Charges Investigation and AUSF dockets. Stated in the barest form, these
18 consolidated dockets set out to decide two essential questions: First, what rate levels should the
19 Arizona Corporation Commission set as the goal for this phase, and second, how should local
20 exchange carriers ("LECs") who reduce their access rates² to those levels recover the lost
21 revenue?

22 ¹ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, p. 4, lines 13-18. *See also*,
23 Prefiled Direct Testimony of Dr. Debra J. Aron, Hearing Ex. AT&T-1, p. 22, lines 5-14 - p. 23, lines 1-2.

24 ² Throughout this brief, unless the context indicates otherwise, reference to "access" shall mean intrastate switched
25 access.

1 If change to the current access rates is ordered, it must be consistent with the public
2 interest. Certain core principles comprise the public interest, in the specific context of switched
3 access reform. Reform must be revenue neutral to the incumbent local exchange carriers whose
4 rates have historically been set by regulation under a regulatory compact between state
5 commissions and ILECs whereby local rates were set artificially low in exchange for implicit
6 subsidies from other rates such as access charges. However, in today's competitive environment,
7 where the implicit subsidies are no longer sustainable, local rates need to carry the burden.
8 Further, reform must move to eliminate and not create distortions that permit opportunities for
9 jurisdictional arbitrage and artificially affect market outcomes between and among different
10 technologies and regulatory classes of carriers. Third, reform must proceed deliberately, taking
11 into account that sudden, significant changes risk retail rate shock. Carriers should first look to
12 their own customers to meet their revenue requirements. If carriers are permitted to draw
13 funding from the Arizona Universal Service Fund ("AUSF"), the opportunity must be structured
14 in a way that minimizes the risk of over-burdening the mechanism and the ratepayers statewide
15 who fund it.

16 *The Appropriate Access Rate Target for This Phase*

17 Weighing these principles in the balance, the best rate goal for this phase is that advanced
18 by Qwest. Under the Qwest proposal, all of the LECs in the state, rural and CLEC alike, shall
19 lower their intrastate switched access rates to the Qwest composite rate—which is a rate
20 previously approved by the Commission for Qwest in the earlier phase. While further rate
21 reductions may be taken in the future, the initial step is a measured, prudent move. It is gradual,
22 and avoids rate shock; it lessens the need rural LECs may have to draw from the support funds
23 such as the AUSF; and, it provides significant movement toward eliminating implicit subsidies
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1 while Congress and/or the FCC are developing national plans. The Qwest proposal also
2 substantially mitigates the risk of arbitrage, and best addresses the burgeoning national problem
3 of intrastate traffic pumping—a matter uniquely within the jurisdiction of the states.

4 As noted, access is first and foremost a policy decision, and the participants have
5 submitted economic theory and policy advocacy in this docket. However, there are some hard
6 facts that directly bear on the question of the right access charges for this phase. That evidence
7 exists in the form of contracts for access rates that some IXC's negotiated outside of the
8 Commission's view, and kept secret. Those secret contracts, by definition, evidence what the
9 contracting IXC's were willing to pay for access and the contracting CLEC's agreed to charge.
10 The record shows that the majority of the secret agreements called for intrastate switched access
11 to be pegged to the intrastate rate charged by the ILEC. AT&T's secret contractual arrangements
12 are distinctly at odds with its advocacy that rates be lowered immediately to interstate levels.

13 *Transition Period for This Phase*

14 Access charge reform should continue to be done in phases, as it has been done in
15 Arizona previously. In this phase, since the shifts required by many of the carriers are
16 significant, the Commission should order a multi-year transition period, during which access
17 rates are stepped down and the resulting incremental reduction in revenue is identified. All
18 ILEC's should first look to their own intrastate end users to recover the revenue lost to intrastate
19 access charge reductions. A "fair value" ratemaking analysis is not necessary for revenue neutral
20 modifications to the rate structures of the rural ILEC's, up to a rate benchmark established by the
21 Commission. The benchmark should be uniform for all the rural ILEC's. The CLEC's have rate
22 flexibility, and their access charge reductions should mirror the ILEC in whose serving territory
23 the CLEC is operating, at each step.

1 *Scope of this Phase*

2 This phase should address the rates of rural LECs and CLECs. Qwest is not saying that it
3 is forever insulated from further access charge reductions; rather, once all LECs are at parity,
4 further rate reduction targets should be examined for all LECs.

5 *AUSF Proposals*

6 ALECA and AT&T propose that the AUSF be modified to provide a support mechanism
7 to replace access revenue. Because end users statewide contribute to the fund, they should not be
8 asked to subsidize rates unduly. In order to draw from the AUSF, the LEC should recover from
9 its own customers first, up to the statewide benchmark local exchange basic rate. Only amounts
10 of revenue recovery in excess of the benchmark should be eligible for recovery through a
11 modified AUSF. Further, because the AUSF is an explicit subsidy funded by other providers'
12 customers, any carrier seeking support funds must make a showing of need.

13 The Commission Staff has presented two alternative ways for rural LECs to proceed in
14 conjunction with AUSF support. The Staff's preferred alternative requires a rate case at the start
15 of the process, even if the rural carrier is replacing only a part of its access revenue with
16 increased local rates. The second alternative would allow temporary support from the AUSF for
17 the entire access revenue reduction, subject to later proof of need. These alternatives are too
18 slow, in the first instance, and run the risk of shocking the AUSF system in the second.

19 The AUSF rule must be modified in several respects to allow for LECs to draw from the
20 AUSF to replace lost access revenue. Broader funding support must be established to support
21 increased disbursements, so the rule should require all carriers operating and offering intrastate
22 telecommunications services in Arizona to contribute in an equitable and non-discriminatory
23 manner that is competitively and technologically neutral. Wireline, wireless, and cable
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1 telephone should all contribute to the AUSF, by assessments uniformly calculated, and based on
2 intrastate revenues. Resort to the AUSF for access support is not possible before the necessary
3 rule changes are made and become effective. To be realistic, a plan must provide for sufficient
4 transition time for those carriers seeking AUSF support.

5 *Access Revenue Replacement By Local Rate Increases on a*
6 *Revenue Neutral Basis, Without AUSF Support, Is Permissible*
7 *Without a Fair Value Rate of Return Proceeding*

8 Any carrier that seeks to reduce its intrastate switched access rates toward the target rate
9 should be able to do so and to recover the revenue by increasing the rates for its local services in a
10 revenue neutral amount and fashion.

11 *Under the Qwest Proposal, the Commission Can Begin Reform*
12 *Toward the Objectives It Determines for This Phase And*
13 *Decide How to Deal With the AUSF Support Subsequently*

14 Despite the longstanding duration of the access dilemma, and the understandable desire
15 of several of the national IXC's to reduce access rates as soon as possible, most parties caution
16 against precipitous action. The consumer advocate RUCO in particular urges that the
17 Commission use this proceeding to set a direction, but undertake further analysis and
18 investigation. The prospect that the FCC or congress will finally take action hangs over the
19 proceeding. The likelihood that rates can be reduced as soon as AT&T and Sprint might hope is
20 low, for the reason that the AUSF mechanisms for replacement revenue urged by AT&T does
21 not yet exist. Even if the Commission decides that the AUSF should be used to fund access
22 reductions, rule changes will be necessary. Rule changes could be distant from now.

23 A step that suggests itself would be for the Commission to affirm this phase's rate
24 objective, (which ALECA, Verizon, and Qwest suggest should be to move all rural LECs and
25 CLECs to Qwest's intrastate composite rate), but sequence to a later time that part of the

1 reduction that would be in excess of the benchmarked rate revenue. The first part of the
2 reductions, to be recovered from the rural LECs' rates, could begin with all deliberate speed.
3 The balance of reductions could then be taken subsequently, after the AUSF rules are modified,
4 and the Commission has ruled on (i) what showing if any must be made to recover the balance of
5 the lost revenue through charges to an affected carrier's ratepayers, and (ii) what carriers must
6 show to qualify for support from the Fund.³

7 *Contracts for Switched Access*

8 This docket shines the light of public scrutiny on heretofore secret contracts entered into
9 between certain IXC's and CLECs for switched access. The docket asks what the policy of the
10 State of Arizona should be with regard to agreements between LECs and IXCs for intrastate
11 switched access services. The fundamental notions of common carriage law, including the
12 prohibition on unreasonable rate discrimination apply to CLECS as to their provision of
13 bottleneck switched access services. The rates, terms, and conditions of such contracts must be
14 published and offered to any carrier, without unreasonable discrimination.

15 Further, the evidence shows that one or more CLECs have entered into contractual
16 arrangements that effectively discount the rate for switched access based on the purchase of other
17 services, which may include competitive services and services that are not intrastate. Such

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19 ³ By way of example, if a rural LEC's access rate is 10.2 cents, the Commission will order that rate to be reduced to
20 the Qwest 2.2 cent composite rate, by the following steps: (1) Calculate the revenue that will be lost by reduction of
21 the access rates; (2) Set the benchmark for retail rates in this proceeding. For purposes of this example, assume
22 Qwest's proposed 125% of the statewide retail average; (3) Calculate how much the retail rates of each rural LEC
23 would have to be increased to recover the lost access revenue. This step should be repeated each year because of
24 changing volumes; (4) Cap the retail rate increase at the benchmark level, and implement those increased rates; (5)
25 Simultaneously reduce the intrastate access charge rates for each such carrier to reduce access revenue by an amount
corresponding to the increases to be generated by the retail rate increases; (6) When the AUSF rule changes are
implemented, any remaining access rate reductions can then be made, and the revenue recovered by qualified draws
from the AUSF; (7) In the interest of the important consideration of "gradualism" the intermediate retail rate
changes can be divided into three annual steps, starting upon a Commission order in this phase and on the next two
anniversaries of that date.

1 arrangements obscure and change the tariff rate charged for the bottleneck switched access
2 service based on circumstances and factors that are unrelated to the intrastate switched access.
3 Such arrangements are discriminatory and must be barred.

4 *Lifeline and Linkup Centralized Administration and Enrollment Costs*

5 The social goals of the Lifeline and Linkup programs can best be accomplished by
6 centralized administration and automatic enrollment, through the auspices of the Arizona
7 Department of Economic Security ("DES"). The most efficient funding of that activity by DES,
8 both for DES and the individual carriers, is to expand the scope of the AUSF, to permit it to be
9 used as the funding mechanism.

10 **II. Discussion of Issues**

11 **A. The Participants' Positions in the Proceeding.**

12 The following table shows the positions the participants take on the primary issues in this
13 docket:

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Party	Position	Cite
ALECA	1. Reduce intrastate access composite rate to Qwest's intrastate composite rate.	Meredith Direct, p.7, lines 9-15.
	2. Revenue neutral shift of intrastate access revenues to AUSF using a 2009 base year.	Meredith Direct, p.8, lines 4-6.
	3. No local rate benchmark.	Ibid, p.8, lines 9-14.

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Party	Position	Cite
AT&T	<ol style="list-style-type: none"> 1. All ILECs and CLECs should reduce intrastate access rates. 2. Intrastate access should be reduced to interstate access rates. 3. Revenue neutral shift of intrastate access revenues to local rate, up to a benchmark, with additional recovery from AUSF as necessary. 4. CLECs do not qualify for AUSF for rate rebalancing. 	<p>Oyefusi Direct, p.22, lines 9-18.</p> <p>Ibid, p.25, line 19 – p.26, line 2.</p> <p>Ibid, p.51, line 19 – p.52, line 9.</p> <p>Ibid, p.72, lines 9-16.</p>
Cox	<ol style="list-style-type: none"> 1. Don't reform intrastate access charges until the FCC provides intercarrier compensation reform plan. 2. Long term (over 10 year period) reduce and unify access rates to "bill and keep". 3. Revenue neutral rate rebalancing. 4. Rural ROR ILECs may use increased local rates up to a benchmark and "transitional" support. Transitional support should last no longer than 5 years. 5. Price cap ILECs and CLECs should not need AUSF support, provided they are allowed revenue neutral increases, with subscriber line charges. 	<p>Garrett Direct, p.5, lines 1-4.</p> <p>Ibid, p.8, lines 1-7.</p> <p>Ibid, p.9, lines 1-6.</p> <p>Ibid, p.9, lines 6-11.</p> <p>Ibid, p.10, lines 12-15.</p>
Joint CLECs	<ol style="list-style-type: none"> 1. Reform only rural ILEC intrastate access rates. 2. Reduce intrastate access rates on a case by case basis. 3. Access to revenue replacement through AUSF should be competitively neutral and if available to ILECs also available to CLECs. 	<p>Denney Direct, p.14, lines 13-16.</p> <p>Ibid, p.54, line 11 – p.55, line 4.</p> <p>Ibid, p.66, lines 10-21.</p>

Party	Position	Cite
Sprint	<ol style="list-style-type: none"> 1. Reduce intrastate access rates to interstate levels. 2. LECs should recover intrastate access revenue reductions from their own end users. 3. LECs should not be permitted to recover intrastate access reductions from AUSF unless they prove financial need and demonstrate a public purpose. 4. All ILECs and CLECs should reduce intrastate access. 	<p>Appleby Direct, p.20, lines 6–11.</p> <p>Ibid, p.21, line 11 – p.22, line 7.</p> <p>Ibid, p.22, line 10 – p.23, line 19.</p> <p>Ibid, p.11, lines 6–11.</p>
Verizon	<ol style="list-style-type: none"> 1. All rural ILECs and CLECs should reduce intrastate access to the Qwest RBOC levels. 2. Regulated LECs should be given sufficient retail rate flexibility to recover intrastate access reductions from retail rates. 3. LECs should not be allowed to recover reductions in intrastate access revenues from AUSF. 	<p>Price Direct Testimony, p.3, lines 5–19.</p> <p>Ibid.</p> <p>Ibid, p.21, lines 22–36.</p> <p>Ibid, p.21, lines 6–20.</p>
Staff	<ol style="list-style-type: none"> 1. All rural ILECs and CLECs should reduce their intrastate access rates to the higher of the ILEC or CLEC's interstate access rate or the Qwest intrastate access rate. 2. ILECs must reduce intrastate access as stated above and may recover the revenue reduction in a revenue neutral manner from the AUSF pending a fair value hearing to support the revenue neutral offset. 3. Local rate benchmarks will be determined separately for each company. 	<p>Shand Rejoinder Testimony, p.1, line 26 – p.2, line 5.</p> <p>Shand Direct, p.18, lines 8–20.</p> <p>Ibid, p.16, lines 11–20.</p>
RUCO	<ol style="list-style-type: none"> 1. If Commission decides intrastate access reductions are appropriate and carriers cannot absorb the revenue reduction through changes in existing rates, the Commission should look closely at expanding AUSF. Commission should closely examine a carrier prior to granting AUSF. 	<p>Johnson Direct, p.51, line 24 – p.52, line 2.</p>

Party	Position	Cite
Qwest	1. All rural ILECs and CLECs should reduce their intrastate access to Qwest's intrastate access rate.	Hensley-Eckert Direct, p.7, lines 12-16.
	2. Carriers should be permitted to increase end user rates to a statewide benchmark as a first step to off-setting the reduction in intrastate access revenues.	Ibid, p.7, lines 23-26.
	3. To the extent that increasing local rates is insufficient for revenue neutrality, the AUSF may be utilized if the carrier undergoes a simplified earnings review.	Copeland Direct, p.6, lines 13-26. Ibid, p.8, lines 3-17.

B. Arizona Intrastate Switched Access Target Rates for This Phase

1. Intrastate Switched Access Rates Are a Regulatory Policy Invention, Over Which the States Have Jurisdiction and Considerable Latitude.

The system of implicit subsidies to local service that intrastate switched access charges represent was born out of regulatory policy in the beginning,⁴ and in the absence of a controlling law or federal mandate, it remains a matter for the states to govern in accordance with applicable law. What policy best fits the situation in Arizona? The ultimate destination, the road taken, and the way stops on the journey, are properly the province of the Commission, acting under Arizona law. The weight that the Commission assigns to each of the many and often competing arguments and considerations offered by the participants is for the Commission to decide. Decisions in other states, and exhortation from various quarters may provide guidance, but do not control. Previous pronouncements made by the Commission about the objective of mirroring intrastate and interstate access rates, while providing direction, do not preclude the exercise of

⁴ "It has always been the case that access is a matter of government regulatory policy." Direct Examination of RUCO witness Dr. Ben Johnson, Tr. 82:18-19.

1 prudence and discretion in this phase or any other.

2 **2. The Commission Should Avoid the Extremes in Fixing a Target Rate for**
3 **Access Reductions. The Qwest Proposal Represents the Reasonable Middle**
4 **Course.**

5 When all of the positions of the participants are laid side by side and explained, it is clear
6 that there are positions ranging from doing nothing now, to a drastic immediate reduction of
7 access to the low interstate levels. The clear center of gravity is a reasonable middle ground
8 between the extremes advocated by some of the parties to the proceeding. That middle ground is
9 the Qwest proposal.

10 At one extreme AT&T⁵ and Sprint⁶ advocate for reduction of all LECs' rates to the same
11 level as their respective interstate rates as soon as possible. On the other extreme, the joint
12 CLECs advocate that nothing should be done with respect to their interstate switched access
13 rates, at least at this time.

14 The bulk of the advocacy lies in between. The rate level position espoused by the largest
15 group of parties is that of Qwest,⁷ Verizon,⁸ and ALECA.⁹ They urge that the goal should be for
16 the rural LECs' intrastate switched access rates to be reduced to the Qwest composite rate, and
17 for the CLECs' rates to be the same as the ILEC in the service area.

18 This position is the reasonable center in the proceeding, and is aligned with aspects of the
19 positions of the consumer and public interest representatives. RUCO expresses concern about
20 shifting costs onto the local exchange. RUCO articulates six public policy goals that should
21 guide the Commission in its decision making process, but ultimately does not make a discernable

22 ⁵ Prefiled Direct Testimony of AT&T witness Dr. Debra Aron, Hearing Ex. AT&T-1, p. 81:116-18; p. 86:6-8; *see*
23 *also*, Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-7, p. 25:9—26:10.

24 ⁶ Prefiled Direct Testimony of Sprint witness James Appleby, Hearing Ex. Sprint-1, p. 20:6-11.

25 ⁷ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, p. 7:23-26.

⁸ Prefiled Direct Testimony of Verizon witness Don Price, Hearing Ex. VZ-1, p. 3:5-19.

⁹ Prefiled Direct Testimony of ALECA witness Douglas Meredith, Hearing Ex., ALECA-1, p. 7:9-15.

1 proposal for action.¹⁰ RUCO urges that the Commission use the information collected in this
2 proceeding to determine whether it can set a direction, and then conduct more investigation:

3 [I]f the Commission is interested in moving to a certain direction, to my mind the proper
4 step is to announce the direction we are heading, which of the arguments you have heard
5 you find compelling, which ones you don't, and have another round of investigation to
6 better understand the implications for specific types of consumers."¹¹

7 The Commission Staff position evolved to a place between the positions of AT&T and
8 Qwest. Staff holds that CLECs' should adjust their rates to match the ILEC in the local serving
9 area and that rural LECs should move to the Qwest rate or to their individual interstate rate,
10 whichever is greater.¹² Although the Staff's proposed rate target is more reasonable than AT&T
11 and Sprint seek, its disadvantage is that having the rural ILECs' intrastate switched access rates
12 mirror their respective interstate levels allows too much incentive for traffic pumping and
13 arbitrage schemes to arise.¹³

14 The Qwest, Verizon, and ALECA position on rate levels is not only the reasonable
15 middle ground—it also best meets the overarching policy goals articulated by the parties. It will
16 not result in precipitous and tumultuous change such as that which is urged by AT&T. The
17 target—Qwest's composite intrastate switched access rate of 2.2 cents per minute¹⁴—is the only
18 rate level proposed by any of the parties that has been approved by the Commission in any rate
19 proceeding.¹⁵ Reductions by all the LECs to that level will constitute a measured step, providing
20 the best prospect for timely change with manageable consequences for carriers and customers, as

21 ¹⁰ See, section II.B.3, *infra*.

22 ¹¹ Direct Examination of RUCO witness Dr. Ben Johnson, Tr. 71:1-7.

23 ¹² Prefiled Rejoinder Testimony of Staff witness Wilfred Shand, Hearing Ex. S-5, 1:26—2:5.

24 ¹³ See, section II.B.4, *infra*.

25 ¹⁴ Prefiled Direct Testimony of ALECA witness Douglas Duncan Meredith, Hearing Ex. ALECA-1, 7:11-12

¹⁵ Cross Examination of Verizon witness Don Price, Tr. 413:17-20. Qwest's access rates were addressed in its first and second price cap dockets, which were consolidated with Phase I of the instant docket. See, Decision Nos. 63487 and 68604.

discussed more fully below.

3. Application of Dr. Johnson's Six Public Policy Goals.

RUCO witness Dr. Johnson listed six public policy goals that he urges the Commission to use as a checklist used to evaluate the parties' proposals.¹⁶ The six policy goals are:

- (1) The preservation and promotion of affordable, high-quality, universal, basic telecommunications services.
- (2) The maintenance of fair, just, and reasonable rates (inter-customer equity).
- (3) The maintenance of a reasonable level of rate continuity.
- (4) The promotion of economic efficiency.
- (5) The promotion of technological innovations.
- (6) The encouragement of effective competition.¹⁷

While at least one other party endorsed Dr. Johnson's list of policy goals,¹⁸ the applicability and meaning of each of the goals on his list is not without controversy, as will be discussed below.

In any event, the record shows that Qwest's proposal aligns well with the highest priority policy goals that have been identified by Dr. Johnson and others.

(a) Universal Service and Affordability.

There is consensus that affordable universal service is a valid policy objective. As articulated by AT&T in commenting on the policy objectives, "[T]he preservation and promotion of affordable, high-quality, universal, basic telecommunications services" is claimed as one of the objectives in this investigation.¹⁹ However, the weight of the testimony shows that the emphasis has shifted from ubiquity to affordability. Sprint's witness James Appleby testified

¹⁶ Examination of RUCO witness Dr. Ben Johnson by ALJ Rodda, Tr. 120-121.

¹⁷ Prefiled Direct Testimony of RUCO witness Dr. Ben Johnson, Hearing Ex.R-1, pp. 15-16.

¹⁸ Cross examination of Joint CLECs witness Douglas Denney by ALJ Rodda, Tr. 637:16-22.

¹⁹ Cross examination of AT&T witness Dr. Debra Aron by ALJ Rodda, Tr. 347:21-25.

1 that Dr. Johnson's six policy goals will be supported by "setting a residential affordability
2 standard."²⁰

3 Dr. Johnson states:

4 "Switched access service is an important source for revenues that has historically been
5 used to help pay for the costs of providing Universal Service. If these rates are greatly
6 reduced, as some parties are advocating, there will be increased pressure to replace this
7 revenue stream with an alternative source of funding, such as higher local exchange rates.
8 This type of rate rebalancing," as it has been called, *may* endanger the universal service
9 goal, particularly if it is implemented in an *extreme* manner."²¹

10 RUCO's expert issues cautions, but never provides any specifically identifiable
11 recommendations other than to conduct further investigation.

12 Other parties' witnesses provided expert testimony that Dr. Johnson's cautionary
13 approach with respect to universality is not altogether warranted. Verizon witness Don Price
14 testified that the goals of universal service in Arizona have been achieved because consumers
15 have access to quality services that are being provided by a number of competing carriers and
16 technologies at affordable rates."²²

17 AT&T states that Dr. Johnson's direct testimony "is largely rooted in the issues and
18 concerns of the telecommunications marketplace of a decade ago or more. He has declined to
19 seriously grapple with the realities and facts of the current state of affairs in the market, such as
20 the impact of the ubiquity of wireless telephony and the growth of VoIP on concerns about
21 overall telephone penetration, a central topic of his testimony."²³

22 ²⁰ Examination of Sprint witness James Appleby by ALJ Rodda, Tr. 468:4-11.

23 ²¹ Prefiled Direct Testimony of RUCO witness Dr. Ben Johnson, Hearing Ex.R-1, p. 34, lines 16-21. (Emphasis added).

²² Cross examination of Verizon witness Don Price, Tr. 377:2-23.

²³ Prefiled Reply Testimony of AT&T witness Dr. Debra Aron, Hearing Ex. AT&T-3, p. 76, lines 10-14.

1 AT&T agrees that affordability is legitimately a matter of regulatory concern;²⁴ however,
2 AT&T's witness testifies that a wider view of customer options is appropriate, given the ubiquity
3 of wireless coverage and market penetration,²⁵ as well as the increase in VoIP:

4 "As I discussed in my Direct Testimony, even if increasing retail wireline prices caused
5 some customers to drop their wireline telephone service, this would not necessarily have
6 any effect at all on universal service or telephone penetration if those customers choose to
7 rely on other technologies to meet their communications needs. [fn. omitted] Only to the
8 extent that price increases cause customers to drop their wireline phone and to not
9 subscribe instead to cable telephony, wireless, or some other form of telephony, would
10 retail rate increases possibly impact goals of universal service."²⁶

11 Dr. Aron testified that she examined the materials produced in discovery and formed a
12 distinct opinion that local rates could be raised without doing harm to universal service:

13 "In my rejoinder testimony, I believe, I discussed the issue of rate shock and my
14 observations from the materials produced in discovery about the range of retail rates that
15 exist today in Arizona. What I said is that it appears from the range of rates that exist
16 today for the ALECA companies that some rates could be increased without undue --
17 well, in fact probably without any harm to universal service."²⁷

18 Sprint's witness testified that the basic local rates of the LECs operating in Arizona can
19 be increased without jeopardizing affordability, because, even with the local service benchmark
20 increases proposed by Qwest the average rural LEC rate in Arizona would be nearly aligned with
21 the current national average rate.²⁸

22 In summary, testimony shows that in setting the target level for access, the Commission
23 should consider affordability of telecommunications service in Arizona. However no evidence
24 was introduced establishing that universal service, including affordability, was likely to be
25 enhanced, or liable to be diminished, by rate increases at least up to the benchmark levels

²⁴ *Id.*, Prefiled Reply Testimony of AT&T witness Dr. Debra Aron, Hearing Ex. AT&T-3, p. 77, lines 14-16.

²⁵ "Dr. Johnson's testimony fails entirely to recognize that 97 percent of the population in Arizona over the age of 15 has a wireless phone." Direct Testimony of AT&T Witness Dr. Debra Aron, p. 78, lines 1-2, fn. 134.

²⁶ Prefiled Reply Testimony of AT&T witness Dr. Debra Aron, Hearing Ex. AT&T-3, p. 78, lines 4-11.

²⁷ Cross Examination of AT&T witness Dr. Debra Aron, Tr. 297:8-15.

²⁸ Direct Testimony of Sprint witness James Appleby, Hearing Ex. Sprint-1, p. 21, line 11 - p. 22, line 7.

1 proposed by Qwest. The benchmark levels proposed by Qwest are within the range of rates
2 charged by local exchange carriers within this part of the country and in the United States on
3 average.

4 **(b) Dr. Johnson Establishes Rate Continuity as the Most Important**
5 **Factor.**

6 Upon examination by ALJ Rodda, Dr. Johnson clearly prioritized rate continuity as most
7 important of his policy goals:

8 "As far as prioritizing [the list of public policy goals], I think for certain issues, you
9 know, rate continuity or sort of fairness to customers may be the dominant concerns
because it is just a bunch of noise other than that."²⁹

10 Rate continuity is described by him in his Direct Testimony, as bearing on the other
11 policy goals, and as being worthy of being stated separately:

12 Another longstanding principle of rate making is that customers should not be subjected
13 to sudden and extreme increases in rates particularly if the increases are unrelated to
14 improvements in service quality or expansions in service offerings, and even more
15 particularly if no reasonable substitute for the service is readily available. In the present
16 context, it is worthwhile to separately state the goal of rate continuity, because it
17 reinforces the importance of the universal service and equity goals. If the traditional rate
18 continuity principles were ignored, the abrupt nature of the potential increases to local
19 rates could cause subscribers to drop off the system, to the detriment of the universal
service goal. Similarly, regulatory commissions often have found that "rate shock"
should be avoided, or minimized for both equitable and other reasons. Where customers
do not have other viable options (e.g. where effective competition does not exist),
extreme or abrupt rate increases are particularly inappropriate and undesirable. In this
regard it is important to realize that the goal of rate continuity doesn't preclude changes
to the status quo—it merely requires that changes be well justified, and they be
implemented in a gradual manner."³⁰

20 And so, Dr. Johnson's list of policy goals is distilled to a cardinal goal of rate continuity,
21 or as it was also referred to in the hearing, avoidance of "rate shock," or the principle of
22 "gradualism" which assures rate continuity. While other witnesses may give a tip of the hat to

23 ²⁹ Examination of RUCO witness Dr. Ben Johnson by ALJ Rodda, Tr. 121:17-20.

24 ³⁰ Prefiled Direct Testimony of Dr. Ben Johnson, Hearing Ex. R-1, p. 19, line 16 - p. 20, line 4.
25

1 the entire list,³¹ they do not embrace all of them equally. For example, the Joint CLECs witness
2 Douglas Denney stated, "The maintenance of a reasonable rate level of rate continuity, that's
3 kind of just not be shocked but that things get this gradual or what the FCC called a glide path,
4 that things kind of get phased in over time," is particularly important to CLECs.³²

5 The Commission Staff also structures its proposals in the docket around the principle of
6 gradualism.³³

7 Likely, Dr. Johnson concluded that other than rate continuity, the other policy goals "are
8 just noise" because the goals can be used to support any number of conflicting proposals. As
9 witness Denney, who supports the list of objectives, states:

10 "And a lot of [the list of policy objectives] I think may involve trade-offs. You know,
11 there is, efficiency and equity are kind of two different sides of, you know, the
12 marketplace, and there are trade-offs that need to be made between those. And that's
13 where the Commission kind of weighs the value."³⁴

14 But, as discussed above, the concept of rate continuity gets the highest priority among the
15 parties. For those who rate other factors higher, Dr. Johnson's advice to the Commission about
16 how to use his list as a "checklist for measuring the arguments"³⁵ is apt: "Are the [arguments]
17 basically just a disguise form of [that party's] business plan [and that party] would be better off if
18 you lower [its] cost of doing business [or] are they actually showing you it is going to advance
19 universal service [affordability]."³⁶

20 ³¹ Dr. Aron for AT&T, for example, states that she agrees with the six goals (Tr. 346: 21-23), even as she states that
21 Dr. Johnson "does not make any clear policy recommendations and because much of his testimony does not appear
22 to me to lead to discernible policy recommendations[.]" Hearing Ex. ATT-3, p. 76, lines 14-16.

23 ³² Cross examination of Joint CLEC witness Douglas Denney by ALJ Rodda, Tr. 638:11-22.

24 ³³ Cross examination of Staff witness Wilfred Shand, Tr. 668:1-12.

25 ³⁴ Cross Examination of Joint CLECs witness Douglas Denney by ALJ Rodda, Tr. 637:22—638:2.

³⁵ Examination of RUCO witness Dr. Johnson by ALJ Rodda, Tr. 121: 1-6.

³⁶ *Id.*

1 That is the context in which the Commission should examine the ultimate, intermediate,
2 and immediate objectives for intrastate access rate levels, and the processes to reach those levels.

3 (c) **Economic Efficiency Is Discussed in Terms of Rates Based on Long**
4 **Run Incremental Costs. Yet None of the Parties Advocate That this**
5 **Phase Reach that Reduced Level—Because Costs Are Not**
6 **Particularly Meaningful in a Public Policy Debate about Who Pays**
7 **the Costs.**

8 The economists spoke at length about the principle of economic efficiency:

9 “Efficiency is a well recognized goal in utility rate design. Economists describe it
10 as a state in which an optimal level and mix of goods and services is produced, using
11 optimal production methods. . . . In the context of telecommunications regulation, this
12 objective implies that rates should not induce wasteful and inefficient methods of
13 production (either by the utility or by other producers), nor lead to over-or under-
14 consumption of the telecommunications firm’s services. . . . To the extent the
15 Commission seeks to improve or maintain economic efficiency, the logical focus is on
16 marginal cost.”³⁷

17 Dr. Aron testified on behalf of AT&T, “As an economic matter, prices for switched
18 access service should not be higher than the cost of providing access service.”³⁸

19 Yet no party in the docket advocates that the Commission reduce intrastate access rates to
20 the measure of economic costs.

21 Verizon testifies that economically efficient intrastate access rates in Arizona will be
22 promoted by driving the most excessive rates toward *more* efficient levels, and that Qwest’s
23 intrastate access rates are an appropriate target:

24 “Qwest’s intrastate access rates are an appropriate benchmark for this purpose because
25 they have been subject to the greatest regulatory scrutiny and strictest discipline, and thus
represent a just and reasonable price for access. Using Qwest’s rates as a benchmark
would reduce market distortions and promote competitive equity by prompting carriers
with the highest access rates to recover more of their network costs from their own
customers, rather than from other carriers (and their customers) through access rates.”³⁹

³⁷ Prefiled Direct Testimony of RUCO witness Dr. Ben Johnson, Hearing Ex. R-1, p. 29, lines 8-19.

³⁸ Prefiled Direct Testimony of AT&T witness Dr. Debra Aron, Hearing Ex. AT&T-1, 82: 6-7.

³⁹ Prefiled Direct Testimony of Verizon witness Don Price, Hearing Ex. VZ-1, p. 3, lines 7-19.

1 AT&T and Sprint likely will argue that while it is true they do not follow their own
2 advocacy for rate levels that are cost based, their proposals for reductions to the interstate level
3 of the carriers moves farther in that direction. Yet, what the AT&T and Sprint positions really
4 show is that some rates other than cost-based rates can be a legitimate goal. As stated by
5 Dr. Johnson, "I don't think it tells us very much to say the [incremental] cost is close to zero,
6 because the policy issue is still who is going to pay the fixed cost of the network."⁴⁰

7 As noted above, from the beginning, access rates have been freighted with policy
8 judgments. Costs of providing access should not be the major focus of this proceeding.
9 Regarding the cost of providing access, and the IXCs seek to establish that the functionality of
10 terminating intrastate switched access is substantially similar to terminating other calls, such as
11 local, or wireless, or even interstate long distance.⁴¹ The point they try to make is that the rates
12 for intrastate switched access are wildly higher than the cost of the service, and much higher than
13 the rates for the same functionality employed in terminating interstate, wireless, or local calls.
14 These participants miss the big picture. No one contends that intrastate access rates are cost
15 based. As stated by Qwest's witness:

16 "The cost of providing switched access is much lower than the current rates. This has
17 allowed regulators to utilize the higher margins associated with the service to keep the
18 price of the local loop low. Therefore, to the extent that costs are considered by the
19 Commission, they need not be a major focus of this proceeding."⁴²

20 While analysis of costs is not particularly helpful in determining the level for intrastate
21 access charges, the larger policy goal of economic efficiency can be promoted by bringing
22 interstate and intrastate rates closer, and the rates between and among the carriers, closer

23 ⁴⁰ Direct Examination of RUCO witness Ben Johnson, Tr. 85: 3-6.

24 ⁴¹ Direct Examination of RUCO witness Ben Johnson, Tr. 87: 7-19; Cross Examination of Cox witness Douglas
25 Garrett, Tr. 227:24—229:21.

⁴² Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, p. 6, lines 21-24.

1 together. The testimony establishes that the current structure of access charges provides
2 incentives to "game" the system through arbitrage and traffic stimulation, matters which are
3 addressed separately below, in section II.B.4.

4 **(d) Yearly Access Reductions Within Each Phase Are the Best Approach**
5 **to Achieve Gradualism, and Avoid Rate Shock.**

6 As discussed above, among the larger group there is consensus that rate increases made
7 to offset access reductions, to the extent permitted, should be introduced gradually, to avoid what
8 the parties termed "rate shock." The parties testify to that conceptually, and what it means in
9 practical terms regarding implementation of reform. The Staff testified that the reason for
10 recommending against the larger cuts advocated by AT&T and Sprint was the concept of
11 "gradualism," meaning that consumers should be shielded where possible against large increases
12 made all at once rather than made incrementally over time.⁴³ AT&T, one of the two parties
13 seeking for the deepest access reductions to be made "as soon as possible,"⁴⁴ recognizes that the
14 retail rate will have to be restructured, stating, "[B]ecause these rates have been so low for so
15 long, I believe that some gradualism may be necessary."⁴⁵ RUCO states, "While the principle of
16 rate continuity does not preclude rate change, the changes should be made gradually[.]"⁴⁶

17 Gradualism in this context necessarily means a multiple step process. "We see this as a
18 first step of a multi-step process."⁴⁷ Indeed, there is a pattern to follow: When the Commission
19 ordered Qwest to reduce its access rates in the first phase of this docket, the Commission ordered

21 ⁴³ Cross examination of Staff witness Wilfred Shand, Tr. 668: 1-12.

22 ⁴⁴ Cross examination of AT&T Witness Dr. Ola Oyefusi, Tr. 492: 4-6

23 ⁴⁵ Cross examination of AT&T witness Dr. Oyefusi, Tr. 528: 9-11. *See also*, cross examination of AT&T witness
Dr. Debra Aron, Tr. 341:1-5.

24 ⁴⁶ Testimony of RUCO witness Dr. Johnson, Tr. 45:19-20.

25 ⁴⁷ *Id.*, Tr. 61:12-13.

1 four steps of reductions, taken from April 1, 2001 to April 1, 2006.⁴⁸

2 The Staff proposal, while it attempts to pay attention to the principles of gradualism and
3 avoidance of rate shock,⁴⁹ does not provide for a ramping of the changes.⁵⁰ Thus, while Staff's
4 proposal is phased in one sense, in that it calls for reductions in this phase to Qwest's rate, it does
5 not provide for a transition period within the phase. The Staff's proposal is flawed in that regard.

6 **4. The Testimony Shows That the Commission Should Proactively Reduce the**
7 **Incentives For Intrastate Arbitrage and Traffic Pumping, and that Qwest's**
8 **Proposal Holds the Best Promise for Success.**

9 Bringing all LECs' intrastate switched access rates to Qwest's rate levels holds the best
10 promise for reduction of traffic pumping and arbitrage schemes, which have plagued other states
11 that have independent telephone companies with relatively high switched access rates. Traffic
12 pumpers increase the minutes for traffic terminating on high access rate systems, often by
13 partnering with "free" international long distance providers, conference call providers, or porn
14 chat providers to boost demand.⁵¹ Traffic pumping schemes are operated to take advantage of
15 interstate access rates, and others to take advantage of intrastate access rates.⁵² Any proposal
16 that lowers the access rate in the direction of costs will diminish the incentive to pump traffic.⁵³
17 Obviously, the Arizona Commission's ability to reduce rates exists only with respect to the
18 intrastate jurisdiction. And, while the parties agree that the states cannot eliminate the issue
19 completely, states can best ameliorate intrastate traffic pumping, because it is within their
20 jurisdiction.

21 ⁴⁸ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, p. 3.

22 ⁴⁹ Cross examination of Staff witness Wilfred Shand, Tr. 667-668.

23 ⁵⁰ See, Staff Alternative A and B, Prefiled Direct Testimony of Staff witness Wilfred Shand, Hearing Ex. S-1,
24 Executive Summary para. 3.

25 ⁵¹ Cross examination of Sprint witness James Appleby, Tr. 459:6-8.

⁵² Cross examination of Qwest witness Lisa Hensley-Eckert, Tr. 551: 10-12.

⁵³ Cross examination of Qwest witness Lisa Hensley Eckert, Tr. 553:24—554:8.

1 Intrastate traffic pumping takes root where rural access rates are left significantly higher
2 than other LECs' rates in the state, such as the case when calls originated on the Qwest system in
3 metropolitan areas are sent to a "free service" [allegedly] located on the network of a rural ILEC
4 or CLEC. Intrastate traffic pumping is currently a rapidly growing scheme,⁵⁴ and it flourishes
5 because of high intrastate access rates, particularly where there is a significant difference
6 between high rural access rates and lower metropolitan rates.

7 Both the Qwest and the AT&T proposals move in the right direction toward reducing the
8 risk of intrastate traffic pumping, but Qwest's is the better proposal. The AT&T proposal (that
9 rural LECs mirror their own interstate rates) does not eliminate the incentive for traffic pumpers
10 to terminate intrastate calls in rural territory where the ILEC is entitled to charge relatively high
11 interstate access rates. Where high interstate rates are permitted, the AT&T and Staff proposal
12 leaves the intrastate rate high as well, thus leaving intact the incentive to pump minutes of traffic.
13 A rural LEC's interstate rate may be as high as 4.5 cents per minute for local switching under the
14 NECA band 8 rates.⁵⁵ In the cases of those LECs, and in the case of CLECs in that service area,
15 AT&T's proposal does not sufficiently reduce the high intrastate rate, and the incentive remains
16 to pump intrastate traffic. In contrast, the Qwest proposal significantly reduces the high
17 intrastate rate, down to the 2.2 cents per minute rate.

18 The evidence shows that there are other arbitrage schemes, other than traffic pumping,
19 that have been perpetrated in other jurisdictions, usually involving a mischaracterization of the

20 ⁵⁴ "And what I have seen in terms of looking across the nation at all of the different types of scams that IXC's are
21 seeing is that there seems to be a trend in the locations where we see CLEC's entering into rural areas claiming that
22 they are rural CLEC's, claiming that they are allowed to charge that higher rural access rate based on what an ILEC
23 would charge. And as a result, we see, anywhere there are differences in the rates between the companies, we see
24 more traffic pumpers." Direct examination of Qwest witness Lisa Hensley Eckert, Tr. 551:13-21.

25 "And so the traffic pumpers that we have seen [in the interstate jurisdiction] are, on, not as prolific, and, two
really seem to be withering on the vine. We are seeing less and less traffic there." *Id.*, Tr. 552:19-25.

"That's how CLEC's are supporting their businesses these days, is getting involved in traffic pumping."
⁵⁵ Cross examination of Qwest witness Lisa Hensley Eckert by Ms. Wood, Tr. 567:5-17.

1 jurisdiction of the calls. AT&T's proposal for each LEC to reach parity between its interstate
2 and intrastate access rates, addresses one kind of jurisdictional mischaracterization—that in
3 which the arbitrage profiteer wrongfully makes calls appear to be interstate rather than intrastate,
4 in order to pay the lower interstate access rate as an IXC. The “victims” of these schemes are the
5 LECs, not the IXCs. The ILECs represented in this docket all agree that a prudent, substantial
6 step toward removing the incentive to mischaracterize traffic jurisdictionally would be to have
7 all LECs reduce their intrastate switched access to the current Qwest composite rate of 2.2 cents
8 per minute. The AT&T and Sprint proposal for all LECs to reduce to their respective interstate
9 rates would eliminate the difference between interstate/intrastate rates, but the additional benefit
10 represented by their proposal is quite small in comparison the Qwest proposal. The statewide
11 ALECA interstate average rate is 1.6 cents. The weight of the evidence is that the additional
12 strain for ALECA members to reduce its rates the additional 0.6 cents that they would have to do
13 under the AT&T proposal, and the increased demand potentially placed on the universal service
14 fund, counsels strongly in favor of the Qwest rate as the target for all LECs in Arizona.

15 In fact, the biggest current problem with jurisdictional mischaracterization of traffic is
16 making a long distance call appear to be a local call, so that access charges are avoided
17 altogether.⁵⁶ AT&T's proposal only solves a fraction of the problem they claim they are
18 attempting to solve, because, as discussed above, the AT&T proposal would have rural LECs
19 mirror their own interstate rate. Since some rural companies' interstate rates are significantly
20 higher than Qwest's intrastate rate, the AT&T proposal would result in relatively high intrastate
21 access rates for rural carriers, which is an incentive for access charge avoiders to mischaracterize
22 toll as local. In any event, the problem of jurisdictional mischaracterization is already one where

23 ⁵⁶ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, 547:18—548:25.
24
25

1 the FCC has shown that it will make decisions regarding the proper jurisdictional
2 characterization of traffic.⁵⁷ Relatedly, the FCC has made clear rulings as to the jurisdiction of
3 TDM originating and terminating traffic,⁵⁸ and that precedent is useful in prosecuting complaints
4 to enforce access charges for that kind of traffic. Because there are established regulatory
5 rulings, the victims of mischaracterization of jurisdiction can better prosecute administrative
6 complaints or court actions. In comparison, the FCC has only begun to address traffic pumping,
7 and has not done so in an industry-wide manner. Of course, the FCC does not have jurisdiction
8 over the intrastate rates charged by traffic pumping LECs. Therefore, there is good reason for
9 the Commission to take steps to head off intrastate traffic pumping, and that intrastate matter is
10 uniquely within the Commission's jurisdiction.

11 Adoption of Qwest's proposal that all other LECs in the Arizona reduce their intrastate
12 switched access rates to Qwest's level does not foreclose future rate reductions by Qwest or any
13 of the LECs. However, Qwest has already made significant reductions in the previous phase,
14 and for this phase moving all other carriers to the same level is a worthy and achievable goal.
15 Subsequent phases can address the wisdom of targeting even more reductions for Arizona
16 carriers including Qwest, or taking such other actions that may be necessary in light of changes
17 that may be made at the national level.

18 **5. The Secret Agreements between Some IXC's and CLEC's in Arizona Contain**
19 **Negotiated Rates and Are Highly Probative of What AT&T Was Willing to**
20 **Accept as a Fair and Reasonable Access Rate.**

21 Qwest has testified that AT&T, MCI and Sprint have entered into agreements for reduced
22

23 ⁵⁷ *In the Matter of Thrifty Call, Inc., Petition for Declaratory Ruling Concerning BellSouth Telecommunications, Inc., Tariff F.C.C. No. 1*, Declaratory Ruling, 19 FCC Rcd 22240 (WCB 2004), para. 16.

24 ⁵⁸ *Petition for Declaratory Ruling That AT&T's Phone-to-Phone IP Telephony Services Are Exempt From Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457, 7465-67, paras. 12-15 (2004) (declaring that AT&T's "phone-to-phone IP telephony" service is a telecommunications service subject to interstate access charges).

1 switched access rates from a number of CLECs.⁵⁹ The existence of those agreements, and their
2 terms, were kept secret by the contracting parties, and in fact were only produced upon specific
3 order of the Commission, to enforce a Commission subpoena. Qwest testifies that while the
4 terms of the secret access agreements are not uniform, "the most common approach [which is
5 referred to] as the 'straight benchmark' approach simply points to the ILEC's rate in each state as
6 the appropriate benchmark."⁶⁰ AT&T entered into more of the secret access agreements than
7 any other IXC in this docket.⁶¹ These agreements which set rates for access services that applied
8 to the parties to the contract were not filed with the Commission. They were negotiated outside
9 of regulatory proceedings, outside of the view of regulatory agencies, and in private. A powerful
10 inference should be drawn that in these circumstances, the rates negotiated are considered fair
11 and reasonable by each party to the agreement. These agreements are directly relevant to the
12 level at which switched access should be set:

13 "First, the fact that a majority of these agreements benchmark to the ILEC rates is
14 probative of the correct rate level for CLECs in AZ. This is rate which the IXCs
15 overwhelmingly agreed to in negotiations and were willing to pay. This language is
relatively specific, calling out the rates for interstate traffic, intrastate traffic and often
8YY traffic.

16 Second, the agreements show that the CLECs have clearly concur[red] that these lower
17 rates are appropriate for the services they provide. For the CLECs who have entered into
18 these agreements, they have already voluntarily extended these lower rates to other IXCs,
proving that the lower rates are appropriate."⁶²

19 It is important to note that in these contracts, with regard to intrastate access, despite its
20 advocacy that it claims it has urged in all states, AT&T did not negotiate the CLECs down to the

21 ⁵⁹ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, p. 10.

22 ⁶⁰ *Id.*, p. 11.

23 ⁶¹ *Id.* Further detail regarding the secret agreements remains "Highly Confidential." The Highly Confidential
versions of the prefiled Direct Testimony of Lisa Hensley Eckert (Hearing Ex. Q-2, Highly Confidential) and the
Rejoinder Testimony of Lisa Hensley Eckert (Hearing Ex. Q-6, Highly Confidential) show more of that detail.

24 ⁶² *Id.*, p. 12, lines 16-25.

1 CLECs' respective interstate rate, or to the ILECs' interstate rate. Rather, AT&T negotiated to
2 pay the ILECs' intrastate rate. AT&T says it may not have gotten everything it wanted in those
3 negotiations.⁶³ However, AT&T entered into multiple agreements, without compulsion, and did
4 not resort to regulatory proceedings to seek a better rate. In fact, AT&T never pursued a further
5 reduction in switched access rates in Arizona since the first phase of the instant docket regarding
6 Qwest was opened on November 17, 2003. Six and one half years have passed since the
7 Commission bifurcated the dockets between Qwest and all other carriers, and AT&T's only
8 action in that period was the negotiation of the secret agreements. The Commission should
9 conclude from those facts that AT&T was perfectly happy with the rates it had negotiated with
10 the CLECs in the secret deals. The Commission need not now strain to do better than AT&T
11 was content to do for itself.

12 **C. CLECs' Intrastate Access Rates Should Be Capped at Qwest's Intrastate**
13 **Rate Levels; Access Charges in Excess of Qwest's Rate Levels Distorts the**
14 **Market for Local Exchange Services and Invites Traffic Pumping and**
15 **Arbitrage Schemes.**

16 The range of proposals made by the participants with respect to CLEC access rates is a
17 little different than some of the parties have proposed for the rural LECs. AT&T proposes that
18 the CLECs' rates be capped at the rate for the ILEC in whose service territory they operate.⁶⁴
19 The Commission Staff also takes that position, but with the proviso that a CLEC has the "option
20 of filing information with the Commission to demonstrate [that it has higher costs than those of
21 the ILEC] and request a hearing on the issue, if desired."⁶⁵ Sprint asks that CLECs rates (and all
22 LECs) be required to set their access rate and structure for each individual access element equal

23 ⁶³ Prefiled Reply Testimony of AT&T witness Dr. Debra Aron, (Hearing Ex. AT&T-3), p. 73:9-11.

24 ⁶⁴ Prefiled Direct Testimony of Dr. Ola Oyefusi, Hearing Ex. AT&T-7, p. 9:9-24.

25 ⁶⁵ Prefiled Direct Testimony of Staff witness Wilfred Shand, Hearing Ex. S-1, 11:11-22.

1 to the interstate switched access rate and structure.⁶⁶ Cox and the Joint CLECs argue primarily
2 that the Commission should await changes that might come from the FCC or Congress.⁶⁷ The
3 CLECs go on to state that if the Commission decides to include them in access reform, that each
4 CLEC's rates must be based on its own cost structure, and that a transition period be allowed.⁶⁸
5 Qwest advocates that the CLECs' intrastate access rates should be set at the Qwest intrastate
6 level.⁶⁹ Verizon agrees with Qwest, "recommend[ing] that the Commission require all LECs
7 including CLECs, to cap their intrastate access charges at the regional Bell Operating
8 Company's—here, Qwest's—levels."⁷⁰

9 The Qwest and Verizon proposal best advances the policy goals articulated above.
10 Qwest's intrastate rates are an appropriate benchmark for the CLECs for the same reasons that
11 they are an appropriate benchmark for the rural LECs. The Qwest / Verizon proposal is quite
12 similar to the FCC's determination regarding CLEC interstate access rates; the Qwest rates have
13 been subject to the greatest regulatory scrutiny, and thus represent a just and reasonable price for
14 access. Using Qwest's rates as a benchmark would reduce market distortions and promote
15 competitive equity by prompting carriers with the highest access rates to recover more of their
16 network costs from their own customers through other rate elements, rather than from other
17 carriers (and their customers) through access rates. CLECs do not need access to AUSF to
18 replace lost access revenues, because the access revenue is a naked subsidy, and in any event, the
19 CLECs have unfettered retail rate pricing flexibility and may price their retail services as they

21 ⁶⁶ Prefiled Direct Testimony of Sprint witness James Appleby, Hearing Ex. Sprint-1, 5:9-11.

22 ⁶⁷ Prefiled Direct Testimony of Cox witness Doug Garret, Hearing Ex. Cox-1, 3:5-12; Prefiled Direct Testimony of
Joint CLECs witness Douglas Denney, Hearing Ex. JCLEC-1, 6:17—7:7.

23 ⁶⁸ Hearing Ex. Cox-1, 3:13-21; Hearing Ex. JCLEC-1, 13:1-12.

24 ⁶⁹ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, 7:12-16.

25 ⁷⁰ Prefiled Direct Testimony of Verizon witness Don Price, Hearing Ex. VZ-1, 3:7-10.

1 wish.⁷¹

2 The CLECs' access rates are ripe for reform. They have not been significantly modified
3 from the time they were first established—not even when Qwest's rates were being reduced from
4 2001-2006.⁷² “The CLEC rates vary wildly, with some CLECs charging very close to the ILEC
5 rates, and other CLECs charging significantly higher rates . . . however, it is clear that overall the
6 CLEC switched access rates are higher than Qwest's switched access rates.”⁷³

7 According to Verizon, “CLECs have demonstrated a willingness and ability to charge
8 excessive access rates, and that behavior derives from the fact that, once a customer chooses
9 retail service from a CLEC, other carriers have no choice but to deliver calls to the CLEC even
10 though they must incur the CLEC's unreasonably high access rates. Thus, competition does not
11 discipline the CLEC's access rates.”⁷⁴ AT&T stated, “CLECs, as well as ILECs, possess market
12 power in the provision of switched access service. The fact that CLECs face extensive
13 competition in the retail market for local exchange service does not render the market for
14 wholesale switched access service competitive.”⁷⁵ These are the same considerations that led the
15 FCC to benchmark CLECs interstate access at the rate that ILECs are charging for similar
16 service in the market.⁷⁶

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19 ⁷¹ *Id.*, 3:10—4:6. CLECs' switched access tariffs are filed as competitive services, notwithstanding that, as
20 discussed herein, such services are bottleneck. In the competitive category, CLEC's tariffs may be changed upon
notice to the Commission, with the only requirement being that the rate be at or below a maximum rate, and at least
above total service long-run incremental cost. A.A.C. R14-2-1109.

21 ⁷² Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, 3:14 – 4:11.

22 ⁷³ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, 9:6-12.

23 ⁷⁴ Prefiled Direct Testimony of Verizon witness Don Price, Hearing Ex. VZ-1, 4:13-19.

24 ⁷⁵ Prefiled Direct Testimony of AT&T witness Dr. Debra Aron, Hearing Ex. AT&T-1, 86:10-13.

25 ⁷⁶ *In the Matter of Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange
Carriers*, CC Docket no. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC
Rcd 9923, 9941-49 (2001) (“*CLEC Access Order*”), Eighth Report and Order and Fifth Order on Reconsideration,
19 FCC Rcd 9108, 9116-17 para. 17 (2004).

1 Several significant competitive distortions result from excessive CLEC access charges.
2 As AT&T recognizes, traditionally, as the quid pro quo of the monopoly era, ILECs charged
3 high access rates to subsidize local service and promote universal service—but CLECs do not
4 have an obligation to provide service to any customer. They pick and choose their service areas
5 and do not have to provide below cost service to anyone anywhere. “Handing a subsidy to a
6 CLEC is just handing a subsidy, with no benefits for universal service”⁷⁷ That subsidy unfairly
7 funds the CLEC’s competitive efforts, to the detriment of the ILEC. While some CLECs simply
8 match the local rates of the ILEC they compete against, others utilize the subsidy to undercut the
9 local rates by a range of between 18 cents and 4 dollar per month, per line.⁷⁸ “Permitting CLECs
10 to collect unreasonably high intrastate access rates provides those companies with a competitive
11 advantage because they are able to recover disproportionately more of their costs from other
12 carriers rather than from their own end users.”⁷⁹

13 The other major problem is that relatively high CLEC access rates create incentives for
14 traffic pumping for calls terminated by CLECs, just as it does for calls terminated by rural LECs:

15 “And what I have seen in terms of looking across the nation at all of the different
16 types of scams that IXCs are seeing is that there seems to be a trend in the
17 locations where we see CLECs entering into rural areas claiming that they are
18 rural CLECs, claiming that they are allowed to charge that higher rural access rate
based on what an ILEC would charge. And as a result, we see, anywhere where
there are differences in the rates between the companies, we see more traffic
pumpers.”⁸⁰

19 All of the proposals to lower the CLECs’ access rates will tend to ameliorate this problem
20 because lower access rates reduce the incentive for traffic pumping. However, among the three
21 proposals, (i) mirroring the CLEC’s interstate rate, (ii) mirroring the ILEC in the local service

22 ⁷⁷ Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-7, 24:12-20.

23 ⁷⁸ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Haring Ex. Q-1, 6: 13-18.

24 ⁷⁹ Direct Testimony of Verizon witness Don Price, p. 9, lines 16-19.

25 ⁸⁰ Direct examination of Qwest witness Lisa Hensley Eckert, Tr. 552:19-25.

1 area, and (ii) mirroring Qwest's rates, the third, matching Qwest's rates will have the best effect
2 and is the most supportable.

3 Qwest's *intrastate* access rates are the lowest tariff rates among the LECs in the state.⁸¹
4 Therefore if any given CLEC reduces its access to the level of the ILEC in its service area,
5 unless that ILEC is Qwest the resulting CLEC intrastate access rate will be higher than it would
6 be under Qwest's proposal. And, Qwest's *interstate* access rates are the lowest of any of the
7 LECs in Arizona.⁸² Therefore, if any given CLEC reduces its intrastate access rate to its own
8 interstate levels, the resulting rate would still be higher than it would be under Qwest's proposal.
9 The Qwest proposal best addresses the problem of fraud and arbitrage, and reducing competitive
10 distortions.

11 Finally, CLEC protestations against being compelled to reduce their access rates ring
12 hollow in light of the evidence that ****BEGIN HIGHLY CONFIDENTIAL****

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14 Redacted

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16 ⁸⁵ ****END HIGHLY**
CONFIDENTIAL**

17 **D. Regarding Recovery from the AUSF to Recover Revenue Lost to Access**
18 **Reductions.**

19 While RUCO and Sprint object, ALECA proposes that the AUSF be modified to provide
20 a support mechanism to replace some or all of the lost access revenue. The other participants

21 ⁸¹ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. S-1, 7:23-26.

22 ⁸² See fn. 119, *supra*, regarding *CLEC Access Order*.

23 ⁸³ Highly Confidential Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-2, 11:15.

24 ⁸⁴ *Id.*, 12:5.

25 ⁸⁵ Highly Confidential Prefiled Rejoinder Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-6, 5:9—6-13.

1 would permit the possibility, but focus on conditions and restrictions that must be applied, most
2 of which call for rural companies to increase their local rates up to a benchmark level set by the
3 Commission as a condition of drawing on AUSF for greater revenue replacement than their own
4 rates will recover. No entity proposes that CLECs should be eligible for AUSF support. For the
5 AUSF rule to be re-purposed, and to have the base of contributors expanded, rule changes are
6 necessary.

7 Other parties commented as well that a rule change would be necessary.⁸⁶ Among the
8 changes is the need to broaden the base of contributors supporting the fund. Because of the need
9 for the AUSF rule to be changed, any access reform that depends on AUSF necessarily cannot be
10 fully deployed until the rulemaking is concluded, which may be several years in the future.

11 **1. Policy and Legal Considerations that Must Be Evaluated for Each AUSF**
12 **Proposal.**

13 **a. The Existing AUSF Rule Must Be Modified to Accomplish the**
14 **Purposes Proposed.**

15 The existing AUSF rule was adopted by the Commission in 1996, 12 years after the break
16 up of the old Bell system and the change from separations and settlements to an access charge
17 regime.⁸⁷ The AUSF rule provides for high cost support. It does not provide for access revenue
18 replacement. As AT&T stated:

19 “To the extent the Commission decides to give carriers the ability to use the AUSF for
20 the access revenue replacement described under Issues 6 and 7, the Commission needs to
21 revise the existing AUSF rules. The current AUSF rules do not clearly authorize the use
22 of AUSF support to recover reductions in access revenues, nor are they designed to

21 ⁸⁶ For example, see: Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-7, 10:45 –
22 11:7; Prefiled Direct Testimony of ALECA Witness Douglas Duncan Meredith, Hearing Ex. ALECA-1, 9:11-18;
23 Prefiled Direct Testimony of Joint CLEC Witness Douglas Denney, Hearing Ex. JCLEC-1, 69:7-18; Prefiled Direct
24 Testimony of Staff Witness Wilfred Shand, Hearing Ex. S-1, 30:17-24; Prefiled Direct Testimony of Cox Witness
25 Douglas Garrett, Hearing Ex. Cox-2, 10:22 – 11:6.

⁸⁷ Dr. Aron describes the history of the development of access charges. Prefiled Direct Testimony of Dr. Debra
Aron, Hearing Exhibit AT&T-1, pp. 22-24.

1 collect contributions to fund support for that purpose.”⁸⁸
2 Staff also recognizes that the AUSF rule would have to be modified to permit the entire Staff
3 proposal to be carried out. The purpose of the fund, its amount, and how it is funded are all
4 matters that are implicated in any of the parties’ proposals to support access reform. Staff
5 witness Shand agrees that the AUSF fund would have to change from a high cost support fund to
6 a high cost and access charge revenue support fund, an obvious change of its role and its
7 amount.⁸⁹ Mr. Shand also testified, “A specific provision would have to be added to the rules to
8 allow for the use of AUSF revenues to compensate carriers for revenue reductions resulting from
9 Access Reform. However, a waiver of the rules would allow the Commission to immediately
10 implement intercarrier compensation reform, which Staff believes is in the public interest.”⁹⁰
11 Qwest submits that while certain requirements of rules may in circumstances of emergency or for
12 good cause be waived, the *scope* of an existing rule cannot be *expanded* by waiver.

13 **b. Swapping One Subsidy (Access) for Another Form of External**
14 **Support (Such as AUSF) Does Not Provide Adequate Reform.**

15 ALECA proposes that the AUSF be modified to provide a support mechanism to replace
16 lost access revenue. ALECA’s proposals would result in the highest level of support from the
17 AUSF. The problem is that merely replacing one subsidy for another, without difference in the
18 amount of the total subsidy, does not alter the inefficiency. “If retail prices for traditional
19 switched local service are held at artificially low, below-cost levels, consumers will demand
20 more of that service than they otherwise should, and as discussed earlier, companies decisions to
21 invest in the alternative technologies will be distorted by artificial (incorrect price signals that not

22 ⁸⁸ Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-7, 71:7-16.

23 ⁸⁹ Examination of Staff Witness Wilfred Shand by ALJ Rodda, p. 707: 4-12.

24 ⁹⁰ Prefiled Direct Testimony of Wilfred Shand, Hearing Ex. S-1, p. 29, lines 14-24.

1 based on society's' real cost."⁹¹

2 High AUSF support comes at the expense of ratepayers of all the LECs and IXC's in the
3 state who pay into the AUSF by way of surcharges on their telephone bills. Thus to the extent
4 that AUSF is modified and permitted to provide revenue replacement for lost access charges, the
5 subsidy is merely shifted from the IXC's who currently pay switched access, to end users of all
6 companies. "Allowing companies to shift too much of their costs to switched access purchasers
7 (and their retail customers) places a disproportionate burden on other carriers in the state—and
8 ultimately, their customers—subsidize those companies' services."⁹² Prior to receiving access
9 replacement fund support through a general surcharge on intrastate revenues of other carriers, the
10 fund recipient needs to ensure it is charging appropriate and fair rates to its end user
11 customers."⁹³

12 (i) **ALECA's Proposal for a Portion of the AUSF Support to Be**
13 **Based on Embedded Cost Algorithms Used to Calculate the**
Federal High Cost Loop Support Should Be Refused.

14 ALECA proposes to use the same algorithms in the AUSF that are used to calculate the
15 federal High Cost Loop Support in the interstate jurisdiction for rural companies. That would
16 result in funding of all costs that are above 115 percent of the national average loop costs.⁹⁴
17 ALECA's suggestion to use nationwide average costs in Arizona calculations is too removed
18 from state conditions. Qwest proposed to use state wide local exchange rates, for example, and
19 the Staff criticized that viewpoint, saying the proposal "ignores the disparate cost of providing
20 service and the different effects the rate increase require might produce."⁹⁵

21
22 ⁹¹ Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-8, p. 52, line 22 - p. 53, line 3.

⁹² Prefiled Direct Testimony of Verizon witness Don Price, Hearing Ex. VZ-1, p. 14, lines 2-6.

⁹³ Prefiled Direct Testimony of Qwest witness Peter Copeland, Hearing Ex. Q-7, p. 4, lines 4-7.

⁹⁴ Reply Testimony of Qwest witness Peter B. Copeland, Hearing Ex. Q-8, p. 7, lines 4-11.

⁹⁵ Prefiled Direct Testimony of Staff witness Wilfred Shand, Hearing Ex. No. S-1, p. 16, lines 13-20.

1 Qwest believes that the Commission should strive to ensure that end user customers are
2 treated in a fair and consistent manner throughout the state—a thought that leads to the setting of
3 a statewide benchmark retail rate as the threshold for entry into receiving access replacement
4 support.⁹⁶

5 The ALECA proposal is not supported by any other party. For the reasons stated above,
6 it should not be adopted.

7 **(ii) The Staff Proposal for Individual Company Benchmarks Does**
8 **Not Provide Certainty or Uniformity Regarding the Threshold**
for Support and Should Be Denied.

9 Staff opposes implementation of a statewide benchmark as AT&T and Qwest have
10 suggested, theorizing that individual LEC circumstances differ and should drive different
11 outcomes. Staff supports retail rate benchmarks determined on an individual company basis.⁹⁷
12 Staff's proposal involves multiple separate adjudicative proceedings, each of which will result in
13 a unique benchmark. Besides causing an enormous draw on the resources of the Commission,
14 these proceedings will not work as well as the competing benchmark proposals to reduce the
15 subsidies and narrow disparities between the retail rates among the LECs:

16 “[Under Staff’s company specific benchmark proposal] no company’s fair value rate of
17 return application would establish a minimum acceptable level for end user charges prior
18 to being considered for a grant of AUSF. In contrast, Qwest’s proposal for a state-wide
benchmark would create a minimum acceptable level for end user charges as part of the
fair value rate of return application.”⁹⁸

19 AT&T makes the point that individual carrier specific benchmarks will not work toward the long
20 goal of closing gaps between urban and rural rates.⁹⁹

21 In summary, while Qwest stated that Qwest could accept Staff’s company specific

22 ⁹⁶ Prefiled Direct Testimony of Qwest witness Peter Copeland, Hearing Ex. Q-7, p. 4, lines 10-13.

⁹⁷ Prefiled Direct Testimony of Staff witness Wilfred Shand, Hearing Ex. S-1, p. 28, lines 36-42.

23 ⁹⁸ Prefiled Reply Testimony of Qwest witness Peter Copeland, Hearing Ex. Q-8, p. 5, lines 11-15.

⁹⁹ Prefiled Reply Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-9, p. 39, lines 1-11.

1 benchmark proposal, it will not serve the purposes of the proceeding as well as Qwest's state
2 wide proposal, and is not the preferred result.¹⁰⁰

3 **(iii) AT&T's Proposal that Rural LECs Need Not Raise Local**
4 **Rates to the Benchmark Level to Receive AUSF Support**
Should Be Denied.

5 AT&T states that rural LECs should be accorded flexibility to price their services and the
6 opportunity to increase retail rates for local service up to a benchmark, "however, the
7 Commission should not require carriers to raise local service rates by any amount."¹⁰¹ Then,
8 "[T]hat LEC would be eligible to receive support from the Arizona universal service fund
9 (AUSF) and its level of support will be determined *as if it had raised its retail local rate up [to]*
10 *the benchmark level.*"¹⁰² Permitting a LECs to draw from the AUSF when it has not actually
11 raised its local rates to the benchmark level defeats the policy objective of ensuring it is charging
12 appropriate and fair rates to its end user customers, and is contrary to AT&T's own statement
13 about effective benchmarks: "[T]he Commission should ensure that, first, the benchmark allows
14 as much cost recovery from end users as possible subject to affordability concerns."¹⁰³

15 **(iv) Expanding the Base of Contributors to the AUSF to Support**
16 **Access Reform.**

17 Qwest's position on funding and expanded-role AUSF is as follows:

18 If the Commission increases the current AUSF disbursements by including intrastate
19 access replacement support, the funding mechanism for AUSF must be addressed. The
20 source of the funding of the AUSF should be based on a method that requires all *carriers*
21 *operating and offering intrastate telecommunications service* in Arizona to contribute in
an equitable and non-discriminatory manner. The fund should be sustainable and
competitively and technologically neutral. *Carriers operating wireline, wireless, and*
cable telephony should all contribute to the AUSF (and potentially receive funds from it,

22 ¹⁰⁰ Prefiled Reply Testimony of Qwest witness Peter Copeland, Hearing Ex. Q-8, p. 5, lines 16-19.

23 ¹⁰¹ Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-7, p. 51, line 24 - p. 52, line 9.

24 ¹⁰² *Id.* (Emphasis added).

25 ¹⁰³ *Id.*, p. 55, lines 22-23.

1 as an eligible telecommunications carrier [ETC]) in an equal manner. The contributions
2 could be based on total retail telecommunications intrastate revenue.¹⁰⁴

3 The current method of funding AUSF, which assess 50 percent of the collection burden on
4 traditional long distance carriers, is not sustainable.¹⁰⁵

5 AT&T concurs with Qwest. "Contributions to the AUSF, to satisfy the existing support
6 needs and the access revenue replacement function proposed here, should come from *all*
7 telecommunications providers, on an equitable, non-discriminatory and competitively neutral
8 basis."¹⁰⁶ Staff also seems to agree: "Staff recommends that the AUSF surcharges be assessed
9 on jurisdiction retail revenues rather than the current methodology . . . Implementation of this
10 recommendation would require a rule change or amendment."¹⁰⁷

11 However, Verizon and the Joint CLECs contend that AUSF surcharges should not be
12 assessed on wireless or VoIP services: "The Commission should not burden new services and
13 technologies (and the customers that use them) with legacy regulatory obligations that have
14 outlived their usefulness."¹⁰⁸

15 Qwest respectfully submits that the record on this question requires further
16 development—and that since a rule change is involved—further proceedings must necessarily be
17 undertaken.

18 **2. Different Showings Should Be Required For the Different Ways LECs Might
19 Seek to Recover Access Reform Revenue Reductions.**

20 **a. Revenue Neutrality Is All That Should Be Shown By Carriers That
21 Move on Their Own Initiative to Lower Their Access Rates and**

22 ¹⁰⁴ Prefiled Direct Testimony of Qwest witness Peter Copeland, Hearing Ex. Q-7, p. 8, line 18 - p. 9, line 10.
(Emphasis added).

23 ¹⁰⁵ *Id.*, p. 9, lines 2-5.

24 ¹⁰⁶ Prefiled Direct Testimony of AT&T witness Dr. Oyefusi, Hearing Ex. AT&T-7, p. 73, lines 19-22.

25 ¹⁰⁷ Prefiled Direct Testimony of Staff witness Wilfred Shand, Hearing Ex. S-1, Executive Summary, para. 11.

¹⁰⁸ Prefiled Reply Testimony of Verizon witness Don Price, Hearing Ex. VZ-2, p. 23, lines 18-20.

Replace the Revenue With Rate Increases on Other Services, and Do Not Seek AUSF Support.

As noted, most of the participants urge that if the rural LECs are not going to absorb the revenue losses from access rate reduction, that they recover the losses from their own customers first. The weight of the testimony supports the position that if the amount of revenue from rate increases is equal to or less than the amount of revenue forgone through access charge reductions and the LEC is not going to seek AUSF support, that the carrier may be permitted to institute the replacement revenue rate changes without filing a rate case or a Rule 103 filing. The carrier need only make a showing that the rate changes are revenue neutral. The Commission Staff states:

“Staff believes that a change to other rates of the company could be made to offset the switched access charge reduction as long as the change in rates was overall revenue neutral outside of a rate case. Staff believes that such a scenario would be permissible under the Scates case.”¹⁰⁹

This is consistent with Qwest’s and AT&T’s positions that carriers may seek “revenue neutral” increases in local rates.¹¹⁰ Qwest explains that such revenue neutral increases should include multi-year transition periods for moving to the local rate benchmark.¹¹¹ Mr. Copeland describes how a revenue neutral mechanism might work in his direct testimony.¹¹² Dr. Oyefusi provides a similar description in his direct testimony on behalf of AT&T.¹¹³

¹⁰⁹ Prefiled Direct Testimony of Staff witness Wilfred Shand, Hearing Ex.S-1, Executive Summary, para. 7.

¹¹⁰ Although Qwest and AT&T state that revenue neutral increases should be allowed in the context of using benchmarks to qualify for AUSF support, the same revenue neutral logic applies as well to access replacement without resort to AUSF.

¹¹¹ Prefiled Direct Testimony of Qwest witness Peter Copeland, Hearing Ex. Q-7, p. 7, lines 10-11.

¹¹² *Id.*, p. 7, line 16 - p. 8, line 2.

¹¹³ Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-7, pp. 69-70.

1 Sprint too, states that when a LEC files a tariff to change a local rate, and that changed
2 rate remains at or below the local rate benchmark, the filing should be approved.¹¹⁴

3 Verizon's position also supports revenue neutral rate increases without a rate case,
4 *specifically in the context of access reform without resort to AUSF:*

5 "As noted above in response to Issues 3 and 5, the Commission should give carriers
6 sufficient retail rate flexibility to recover lost access revenues through their retail rates,
7 since it is appropriate for carriers to recover their network costs from their own end users,
8 rather than from their competitors. A quantification of the revenue reduction associated
9 with the ordered access reductions, supported by affidavit, should constitute a sufficient
10 showing to permit recovery of up to at amount via retail rates. Establishment of
11 "benchmark" rate is not necessary under this approach."¹¹⁵

12 Allowing carriers to raise local rates to offset access charge reductions, is justified in
13 light of the history of access charges, and is entirely consistent with the Arizona "fair value"
14 requirement of rate setting. As discussed above, access charges are the creature of policy
15 decisions made in the context of rate regulation. The disparities between intrastate and interstate
16 switched access rates "is purely artificial, driven by legacy regulation."¹¹⁶ LECs should not bear
17 the burden of changing regulation policy:

18 "[The rural LECs] are all starting from a different price, and it has been part of our
19 history. And now all we are trying to do is transition into a new system. . . . I know
20 there has been testimony that you should let them eat it. No, I don't think that is a fair
21 solution. I think that society has agreed to that system, we have all lived under that
22 system, and we will all agree that it has benefited the industry. We are just going through
23 changes. And nobody should be penalized and you should try to do that transition the
24 fairest way possible."¹¹⁷

25 These parties are essentially asking that rate changes associated with access reform proceed just
as they were done when access charges were instituted:

¹¹⁴ Prefiled Direct Testimony of Sprint witness James Appleby, Hearing Ex. Sprint-1, p. 22, lines 1-7.

¹¹⁵ Prefiled Direct Testimony of Verizon witness Don Price, Hearing Ex. VZ-1, p. 21, lines 22-35.

¹¹⁶ Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-7, p. 20, lines 15-19.

¹¹⁷ Examination of AT&T witness Dr. Ola Oyefusi by ALJ Rodda, Tr. 536:9-22.

1 "In other words, those rates were essentially established in the 1984 time frame to simply
2 serve as a replacement mechanism for the toll settlements that had existed prior to that
3 time. There was no examination of cost at the time. It was simply a make whole
4 mechanism that was created so that those revenues could then be generated by bills to
interexchange carriers rather than through the toll settlements process that had existed for
decades prior to that time."¹¹⁸

5 For the foregoing reasons, revenue neutral rate increases should be approved upon a showing of
6 revenue neutrality, and not upon determination of fair value and rate of return.

7 **b. Staff's and Several Other Parties' Proposals Rightfully Require A**
8 **Showing of Need for AUSF Support of Access Reductions; Qwest's**
9 **Proposal or a Statewide Benchmark and Revenue Neutral Rate**
10 **Increases Coupled With Demonstration of Need for AUSF Support**
11 **for Further Access Reductions, Is Easier to Administer and Fully**
12 **Satisfies the Public Interest.**

13 **(i) The Qwest Proposal**

14 As a condition for allowing draws from AUSF for access replacement, as noted above
15 Qwest advocates that the applicant must have local rates that meet a statewide benchmark of
16 125% of the average retail rates, *plus* demonstrate a showing of need by filing Rule 103
17 information.¹¹⁹ In connection with that approach, Qwest believes that the portion of the access
18 recovery to be made through local rate increases by the carrier may be accomplished by revenue
19 neutral rate changes for the reasons described above. Under Qwest's view, carriers may begin to
20 reduce access, and increase local rates on a revenue neutral basis, and reduce the balance of the
21 access rates down to the target later, after necessary AUSF rule changes are made, and the carrier
22 has demonstrated need. Compared to Staff's approach, Qwest's proposal is simpler, easier to
23 administer, and will permit carriers to begin access reform faster.

24 ¹¹⁸ Cross examination of Verizon witness Don Price, Tr. 378:20—379:3.

25 ¹¹⁹ Qwest notes that Rule 103 information must be supplied under the current AUSF rules in order to receive high cost support. Prefiled Direct Testimony of Qwest witness Peter Copeland, Hearing Ex. Q-7, 8:8-17.

1 The increase of local rates up to the benchmark should not require a rate case, because it
2 is part of a revenue neutral plan for access replacement, for the reasons stated above. However,
3 the reasonableness of the approach is proven by modeling done by Dr. Oyefusi on behalf of
4 AT&T.

5 Dr. Oyefusi testified that the statewide benchmark rates (either those proposed by Qwest,
6 or the average metropolitan area rates mentioned by AT&T, which are for all intents and
7 purposes very close) are fair to ratepayers. Dr. Oyefusi compared the benchmark rates to the
8 retail rates of fourteen Arizona LECS:

9 "Q. Will basic service remain affordable if retail rates are allowed to increase
10 to the "benchmark" amount Qwest suggests?

11 A. Absolutely: in fact, Qwest's suggestions would yield a benchmark at the
12 low end of a reasonable range. In most instances, rates would increase to levels that still
13 fall below what they would have been if they had just kept up with inflation since the last
14 time those rates were changed. An AT&T analysis of fourteen Arizona ILECs (based on
15 publicly available data) reveals that the weighted average inflation adjusted retail rates
16 for residential local service would be \$17.50 compared with the \$13.60 paid today, on
17 average. [fn. omitted] This means as a practical matter, if one of the benchmarks
18 identified above were adopted, each customer's price for service in real terms (that is,
19 adjusted for inflation) would not have changed."¹²⁰

20 Furthermore, the reasonableness of the Qwest benchmark (and by extension the local rate
21 increases that would be made to the benchmark), are consistent with or lower than benchmarks
22 set in New Mexico, Indiana, Pennsylvania, New York, and Alaska, as examples.¹²¹ The
23 testimony of Sprint witness James Appleby is that "Qwest's suggested local service benchmark
24 approximates the current national average rate."¹²²

25 In summary, the retail rate increases that will result from use of the Qwest-proposed

¹²⁰ Prefiled Direct Testimony of AT&T witness Dr. Ola Oyefusi, Hearing Ex. AT&T-7, p. 59, line 7 - p. 60, line 5.

¹²¹ *Id.*, p. 60, lines 6-13.

¹²² Direct Testimony of Sprint witness James Appleby, Hearing Ex. Sprint-1, 21:18-19.

1 benchmark will be reasonable and affordable, and are easily determined once the access
2 reduction target is established.¹²³ Qwest contends that its benchmark may be adopted by the
3 Commission in this proceeding based on the testimony in the record. Staff's proposal, by
4 contrast, will not be known for any given carrier until a rate determination process is completed.

5 **(ii) Staff Alternatives A and B**

6 Under the Staff's proposal, whenever a company seeks AUSF support the Staff would
7 require different filing requirements, and a benchmark for any given company would not be
8 determined under the Staff's proposal until a full rate analysis is made by the Commission.
9 Under Staff's preferred Alternative A, a carrier must file Rule 103 information "to allow the
10 Company and the Commission to increase rates to levels that generate additional revenues while
11 providing service at reasonable rates before they are authorized to receive AUSF surcharge
12 subsidies."¹²⁴ Before AUSF support is actually awarded, a fair value finding and a fair value rate
13 of return finding must be completed.¹²⁵ Qwest submits that under Staff's proposed Alternative
14 A, it seems to require three Commission determinations. First, Staff states that the Commission
15 must allow the rate increase, using Rule 103 information. It is not clear whether that is a full rate
16 proceeding, but the issue could be avoided by accepting Qwest's proposal for a statewide
17 benchmark. Under Staff's proposal, the benchmark and the corresponding determination of
18 AUSF support must be decided as part of the fair value and rate of return proceeding. Qwest
19 respectfully submits that its statewide benchmark and revenue neutral rate increase proposals
20 described above are easier to administer and meet the public interest.

21 Under Staff's Alternative B, its less preferred approach, Staff would have the

22 ¹²³ Prefiled Direct Testimony of Qwest witness Peter Copeland, Hearing Ex. Q-7, 7:16—8:2.

23 ¹²⁴ Prefiled Direct Testimony of Staff witness Wilfred Shand, Hearing Ex. S-1, p. 18, lines 16-20.

24 ¹²⁵ *Id.*, Executive Summary, para. 7.

1 Commission allow a rural LEC to immediately file for AUSF support on a temporary basis, with
2 the permanent support to be subsequently determined in a rate case. This proposal is not optimal
3 in Qwest's view, for several reasons. First, it assumes that the Commission can increase the
4 permitted uses and expanded contribution of AUSF by a "waiver" of the rule—a proposition
5 with which Qwest does not agree.¹²⁶ Second, even if it could be done, Alternative B will provide
6 AUSF support without proof of need, at least while the rate case is pending. The customers of
7 Qwest and other companies who contribute to the AUSF should not be asked to bear that
8 unproven burden.

9 **E. Arizona Should Permit Contracted Switched Access, Provided the**
10 **Agreements Are Published, and that the Same Rates, Terms and Conditions**
11 **Are Extended to All IXC's in a Non-Discriminatory Manner; Agreements**
12 **that Modify the Rates For Switched Access Based on the Purchase of Other**
13 **Services Should Be Banned.**

14 At Qwest's urging, this docket seeks to determine the policy of Arizona with regard to
15 contracts between providers of switched access services and their captive IXC customers. Most
16 parties state that contracts for switched access service should be permitted, with conditions.¹²⁷
17 The Commission Staff recommends that the Commission require the filing of such agreements
18 on a going forward basis.¹²⁸ The testimony shows that switched access service provided by
19 ILECs or by CLECs is a monopoly and IXCs have no choices that permit them to avoid
20 purchasing that service.¹²⁹ Qwest agrees with the Staff that agreements of that nature should be
21 filed with the Commission or otherwise published, for all to see, and the contract's provisions
22 should be available to any other IXC customer.

21 ¹²⁶ See, fn 67, supra.

22 ¹²⁷ RUCO and the Joint CLECs state that strict adherence to the tariff regime should apply. Prefiled Direct
23 Testimony of Joint CLECs witness Douglas Denney, Hearing Ex. JCLEC-1, p. 55; Direct Examination of RUCO
24 witness Dr. Johnson, Tr. 60: 6-12.

25 ¹²⁸ Prefiled Direct Testimony of Staff witness Wilfred Shand, Hearing Ex. S-1, Executive Summary, para. 4.

¹²⁹ *Id.*

1 Never again should carriers be allowed to enter into secret agreements such as those
2 described above in Section II.B.5. The fundamental notions of common carriage law apply to a
3 CLEC's provision of bottleneck switched access service. Extending a secret rate, such as these
4 contracts have done, violates Arizona law:

5 40-334. Discrimination between persons, localities, or classes of service
6 as to rates, charges, service or facilities prohibited

7 A. A public service corporation shall not, as to rates, charges, service,
8 facilities or in any other respect, make or grant any preference or
9 advantage to any person or subject any person to any prejudice or
10 disadvantage.

11 B. No public service corporation shall establish or maintain any unreasonable
12 difference as to rates, charges, service, facilities or in any other respect,
13 either between localities or between classes of service.¹³⁰

14 The rates, terms, and conditions of such contracts must be published and offered to any
15 carrier, without discrimination. Qwest's position is that the rate paid for switched access should
16 be the same for every IXC for every minute of use.¹³¹

17 The record reveals very clearly that, for many years, a host of Arizona CLECs have
18 engaged in unlawful rate discrimination by providing a select few IXC customers secret, and in
19 some cases massive, discounts off of the CLECs' tariff switched access rates.¹³² The CLECs did
20 not file these agreements with the Commission, did not append them to their tariffs and did not
21 alert other (non-preferred) IXCs of the possible discounts. In this the proceeding, the CLECs fail
22 to offer any intelligible basis for the favoritism shown to certain IXCs, but not others, for the

23 ¹³⁰ A.R.S. 40-334.

24 ¹³¹ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, 16:3-4.

25 ¹³² See, section II.B.5, *supra*.

1 identical bottleneck service. The Commission should put an immediate stop to this
2 anticompetitive, inequitable rate discrimination.

3 The testimony also shows another serious problem with some of the secret contracts that
4 requires attention. One of the CLECs, Cox, has entered into contractual arrangements with
5 AT&T that effectively discounts the rate for switched access based on the purchase of other
6 services, which may include competitive services and services that are not intrastate. Cox
7 admitted that its contract with AT&T discounts the switched access rate based on the purchase of
8 special access service (also called private line service or transport)—which are services that can
9 be purchased from other carriers. And, “there may be other competitive services included in that
10 agreement.”¹³³ Such arrangements obscure and change the rate charged for the bottleneck
11 switched access service based on circumstances and factors that are unrelated to the intrastate
12 switched access. It is not clear what the effective rate actually charged to AT&T might be under
13 the contract, because it depends on the volume of special access services AT&T purchases. Nor
14 is it clear how much of the special access purchases are attributable to the CLEC operations of
15 AT&T as opposed to the IXC operations.¹³⁴ It is patently clear that not all IXCs purchase the
16 same kinds and volumes of “other competitive services” that AT&T may purchase from Cox, so
17 the likelihood that any other carrier could ever achieve the volumes of purchases of those
18 services, which are wholly unrelated to switched access, is remote. Such arrangements are
19 discriminatory and must be barred.

20 Cox disclosed aspects of its agreement to Qwest without claiming confidentiality.

21 ****BEGIN HIGHLY CONFIDENTIAL****

Redacted

22 _____
23 ¹³³ Cross examination of Paul Douglas Garrett, Tr. 240:12—241:22, regarding Prefiled Direct Testimony of Qwest
witness Lisa Hensley Eckert, Hearing Ex. Q-1, 15:1—16:4.

24 ¹³⁴ Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-1, 15:24—16:4.
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****END**

HIGHLY CONFIDENTIAL **

¹³⁵ Highly Confidential Prefiled Direct Testimony of Qwest witness Lisa Hensley Eckert, Hearing Ex. Q-2, 11:11-

¹³⁶ *Id.*

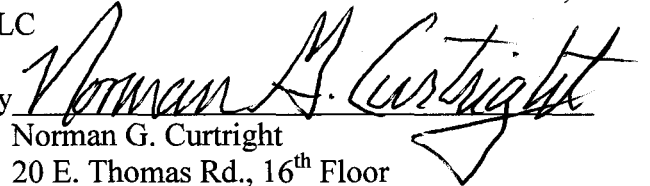
1 **CONCLUSION**

2 For the reasons stated above, the Commission should take a measured, balanced
3 approach, with phased implementation. Qwest's proposals are the best suited to accomplish the
4 policy goals identified, satisfy the public interest, and should be adopted.

5
6 Respectfully submitted, this 9th day of July, 2010.

7 QWEST CORPORATION
8 QWEST COMMUNICATIONS COMPANY,
9 LLC

10 By



11 Norman G. Curtright
20 E. Thomas Rd., 16th Floor
Phoenix, Arizona 85012

12 ORIGINAL and 13 copies hand-delivered
13 for filing this 9th day of July, 2010, to:

14 Docket Control
15 ARIZONA CORPORATION COMMISSION
16 1200 West Washington Street
17 Phoenix, AZ 85007
18
19
20
21
22
23
24
25

1 Copy of the foregoing mailed or emailed
2 this 9th day of July, 2010, to:

3 Jane L. Rodda
4 Administrative Law Judge
5 ARIZONA CORPORATION COMMISSION
6 1200 West Washington Street
7 Phoenix, AZ 85007

8 Elijah Abinah
9 Utilities Division
10 ARIZONA CORPORATION COMMISSION
11 1200 West Washington Street
12 Phoenix, AZ 85007

13 Daniel W. Pozefsky, Chief Counsel
14 Residential Utility Consumer Office
15 1110 West Washington, Suite 220
16 Phoenix, Arizona 85007

17 Gary Joseph
18 National Brands, Inc. d/b/a Sharenet
19 Communications
20 5633 West Polk Street
21 Phoenix, Arizona 85043

22 Craig A. Marks
23 Craig A. Marks, PLC
24 Suite 200-676
25 10645 North Tatum Boulevard
Phoenix, Arizona 85028

Thomas W. Bade, President
Arizona Dialtone, Inc.
6115 South Kyrene Road, #103
Chandler, Arizona 85283

Arizona Payphone Association
c/o Gary Joseph
Sharenet Communications
5633 West Polk Street
Phoenix, Arizona 85043

Will Shand
Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

Maureen Scott
Legal Division
ARIZONA CORPORATION COMMISSION
1200 West Washington Street
Phoenix, AZ 85007

Michael M. Grant
Gallagher & Kennedy, P.A.
2575 East Camelback Road
Phoenix, Arizona 85016-9225

Michael W. Patten
Roshka DeWulf & Patten, PLC
One Arizona Center
400 East Van Buren Street, Suite 800
Phoenix, Arizona 85004

Nathan Glazier, Regional Manager
Alltel Communications, Inc.
4805 East Thistle Landing Drive
Phoenix, Arizona 85044

Joan S. Burke
Law Office of Joan S. Burke
1650 N. First Avenue
Phoenix, Arizona 85003

Mark A. DiNunzio
Cox Arizona Telcom, LLC
MS DV3-16, Bldg. C
1550 West Deer Valley Road
Phoenix, Arizona 85027

1	Dennis D. Ahlers Cathy Murray	William A. Haas Deputy General Counsel
2	Integra Telecom 6160 Golden Hills Drive	McLeodUSA Telecommunications Services, Inc.
3	Golden Valley, MN 55416	6400 C Street SW Cedar Rapids, Iowa 52406
4	Lyndall Nipps	Charles H. Carrathers, III
5	Vice President, Regulatory Time Warner Telecom	General Counsel, South Central Region Verizon, Inc.
6	845 Camino Sur Palm Springs, California 92262	HQE03H52 600 Hidden Ridge Irving, TX 75015-2092
7		
8	Karen E. Nally LAW OFFICE OF KAREN E. NALLY,	Rex Knowles Executive Director - External Affairs
9	PLLC 3420 East Shea Blvd., Suite 200	XO Communications Services, Inc. 7050 Union Park Avenue, Suite 400
10	Phoenix, AZ 85028	Midvale, UT 84047
11		
12	Thomas H. Campbell Michael Hallam	Jeffery W. Crockett Bradley S. Carroll
13	Lewis and Roca, LLP 40 North Central Avenue	Snell & Wilmer L.L.P. One Arizona Center
14	Phoenix, Arizona 85004	400 East Van Buren Street Phoenix, Arizona 85004-2202
15	Brad VanLeur, President OrbitCom, Inc.	Greg L. Rogers Level 3 Communications, LLC
16	1701 North Louise Avenue Sioux Falls, South Dakota 57107	1025 Eldorado Boulevard Broomfield, Colorado 80021
17		
18	Paul Castaneda President, Local 7019	Steve Olea, Director Utilities Division
19	Communication Workers of America 11070 North 24 th Avenue	Arizona Corporation Commission 1200 West Washington Street
20	Phoenix, Arizona 85029	Phoenix, AZ 85007
21	Janice Alward, Chief Counsel Arizona Corporation Commission	Isabelle Salgado AT&T Nevada
22	Legal Division 1200 West Washington Street	645 E. Plumb Lane, B132 P.O. Box 11010
23	Phoenix, AZ 85007	Reno, NV 89520
24		
25		

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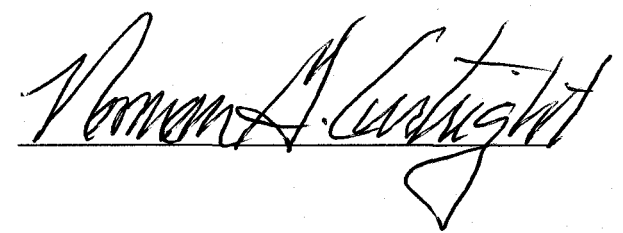
Gregory Castle, General Attorney
AT&T
525 Market Street, Room 2022
San Francisco, CA 94105

Patrick Black
Fennemore Craig
3003 N. Central Ave.
Suite 2600
Phoenix, Arizona 85012

Arizona Reporting Service, Inc.
2200 N. Central Avenue – 502
Phoenix, Arizona 85004

Scott S. Wakefield
Ridenour, Hienton & Lewis, P.L.L.C.
201 N. Central Avenue, Suite 3300
Phoenix, AZ 85004-1052

Stephen Kukta
201 Mission St. – Suite 1500
San Francisco, California 94105

A handwritten signature in cursive script, reading "Norman A. Cartwright", is written over a horizontal line.